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Economic Analysis of Tort Law

Austrian and Kantian Perspectives

Edward Stringham and Mark D. White

Introduction

How should tort law be administered? Neoclassical law and economics offers a clear answer: Tort cases should be decided so as to maximize wealth in dollar terms. Rather than needing to weigh matters of justice, morality, or rights, judges only need to decide cases based on the simple and determinate guidelines of Kaldor-Hicks efficiency. When a tort occurs, the judge simply must weigh the net costs and benefits to all parties and rule according to what maximizes wealth. In cases of positive transaction costs, when the costs imposed on the injured parties are less than the benefits that accrue to the culpable parties, we should allow the harm to continue, and vice versa. Such a system is appealing for those who believe that members of society would be better under a system of efficiency- or wealth-maximization, with little or no concern for matters of justice or rights.[1] Although the guidelines appear simple, economists in the Austrian tradition argue that the theory rests on a few questionable assumptions. Despite its apparent simplicity, the process of using efficiency to determine law raises several issues that render it nonfunctional.

The first half of the chapter outlines positive criticisms of neoclassical law and economics from the viewpoint of Austrian economics. Because Austrians believe that calculation of economic costs and benefits requires a system of property rights, we cannot use economics to determine those very property rights. But Austrian economics itself offers no normative alternative. Whereas neoclassical law and economics includes positive and normative analysis of property rights, economists in the Austrian tradition must rely on a normative theory of property rights from outside economics. The second half of the chapter outlines one such alternative, based on Kantian

ethics, represented by Kantian critiques of the standard approach to tort law in law and economics scholarship. When cases are decided by notions of justice rather than efficiency, judges would not be burdened with the thorny task of calculating all the economic consequences of their decisions. Because a deontological standard does not face the same difficulties, it offers a clear substitute to the wealth-maximization standard.

Positive Criticisms of Neoclassical Law and Economics

Summary of Austrian Arguments

Austrians point to a number of problems with judging law based on economic efficiency. One theme in their critiques is that in absence of market choices, it is not clear how to determine the relevant costs and benefits necessary to render an informed decision. As Mario Rizzo explains, "Much of the efficiency-based economics of law literature sees the tort law as an attempt, however crude, to approximate the outcomes of hypothetical markets."[2] But Austrians feel that this undertaking is more easily said than done. Judges would find it too difficult to measure and compare the willingness-to-pay of the various parties involved in a particular case. Murray Rothbard writes, "In order to do so, everybody's utility scale would have to be investigated by the compensators. But from the very nature of utility scales, this is an impossibility. Who knows what has happened to anyone's utility scale?"[3] Even though neoclassical law and economics considers willingness-to-pay to be based on subjective valuation, it believes that these valuations can be known even outside of market choice. But as Austrians argue, due to the subjective nature of value, preferences can differ greatly between individuals, and, unfortunately, individuals do not have readily apparent utility functions.[4] For judges to make efficient decisions, we would need to believe that they could know individuals' preferences, which is problematic at best.

In "The Mirage of Efficiency," Rizzo argues that the case for the wealth-maximization norm rests on the unrealistic assumption of near perfect information.[5] While most economic analysis of law relies on simplified partial equilibrium models, trying to trace the effects of a law in the real world is next to impossible. "In fact, unless we can acquire a great deal of information about the interrelations between markets, we cannot know if such improvements bring us closer or further from optimality."[6] Outside of static long-run equilibrium, disequilibrium prices make measuring the efficiency of different states of the world very difficult. In the world as it exists, shadow prices are not apparent, and it is not obvious even what to count in our measurement of net wealth.[7] Prices may give us consumer valuation at the

margin, but to consider net wealth we need to measure consumer surplus, and we have no way of measuring the value of inframarginal units.

Edward Stringham makes the case that judges will be unable to measure the costs and benefits associated with various outcomes.[8] Although judges can observe past prices, they are historical artifacts that do not necessarily have any relationship with current market conditions. Judges, as imperfect agents, will have a difficult time evaluating what they think various individuals are willing to pay in cases dissimilar to past events. Judges would need to predict, not what *they* would be willing to pay under different circumstances, but what *others* would be willing to pay. The problem becomes even more complicated when we realize judges have to consider all possible states of the world. To trace out the economic consequences of their decisions, judges would need to know the area under the demand curves for every imaginable circumstance.

But are judges up to this task? Walter Block has often argued that they are not.[9] Because costs are subjective, it will be extremely difficult for judges to know how much each party would be willing to pay (or bribe) to obtain various outcomes.[10] Without knowing willingness-to-pay the judges might not reach the wealth-maximizing solution. Block writes that "the judges might act 'very foolishly' and award the property rights to the wrong person. . . . Can it be expected that judges appointed largely through the political process will judge correctly (more than half the time)?"[11] If judges are unreliable in this respect, giving them discretion to decide cases based on costs and benefits will make property rights more uncertain and erratic, compromising the foundation of the market economy.[12]

In "Law Amid Flux," Rizzo gives a new perspective to the lengthy debate in neoclassical law and economics on the choice between negligence versus strict liability as a basis for accident law.[13] Under a negligence standard, the courts weigh the costs of various actions and hold individuals guilty of a tort if they are judged not to have undertaken "due care," or if the cost of their precautions was less than the expected harm from their actions.[14] Under the latter, the courts ignore precaution and other social costs and proscribe certain actions no matter who the least-cost avoider is. Although the system of strict liability is more simplistic and ignores economic consequences, Rizzo argues that the system is more attractive: "Ironically, it is precisely because we live in a dynamic world where the information needed by the 'fine-tuners' is not available that the answer must be the antiquated and static system of strict liability."[15] He argues that we cannot unambiguously test whether one law is more socially efficient than another, and that even figuring out the most basic things such as the identity of the least-cost avoider is not straightforward when conditions are constantly in flux. "A world in which technological change is permitted involves infinitely greater informational problems."[16] The least-cost avoider will vary under different cost structures, and when we are dealing with disequilibrium prices, the actual opportunity costs are only estimates. "The moral of the story is that costs are not easily measured by outside observers, especially where there is a subjective expectational component to the evaluation of forgone outputs. . . . The ability to know the extent to which market prices are correct is fundamentally an entrepreneurial skill, and the courts are not populated by entrepreneurs."[17]

Roy Cordato also stresses the problem that disequilibrium prices will not reflect the information judges need to decide their cases: "In this setting a Coasian judge faces an impossible task. He must have access to accurate information concerning foregone opportunities associated with the use of the resources under consideration. Yet disequilibrium prices will not accurately convey this information."[18] Judges should not use actual prices as an approximation for general equilibrium prices because if they were identical, the dispute already would have been resolved. As Cordato writes, "If the market generated prices are truly general equilibrium prices, there would be no problem to analyze. If the externality problem actually exists, then the apparent market prices *could not be* general equilibrium prices."[19] He argues that the efficiency norm would require judges to have perfect foresight or require them to continually reassess their decisions.[20] Instead of giving judges such challenges, Cordato supports strict liability and the "coming to the nuisance" doctrine, in which parties could not sue to block a condition, such as noise, that existed before they arrived.[21] Rather than ruling on immeasurable costs and benefits, judges would be given the simpler task of ruling on the proper ownership of titles.[22]

In "Rules Versus Cost-Benefit Analysis in the Common Law," Rizzo lodges the same arguments made about other forms of activist government policy against government activism in law. Because government judges are not omniscient and will have problems predicting the effects of different judgments, he argues that the law should not attempt to impose economic ends on society. Judges can either follow a system where they attempt to balance the societal costs and benefits of each case taken separately, possibly imposing undue costs on some individual members of society,[23] or they can follow a system that attempts to protect the autonomy of the individual through uniformly applied, established rules. Rizzo supports the latter: "The pure common law process produces abstract rules that do not impose a particular hierarchy of ends on society, but simply facilitate the attainment of various individual ends."[24] In this sense, the common law respects the goals of individuals over any social ends sought by policy makers. It resolves conflicts between members of society by balancing their respective rights and

interests in order to preserve fairness or justice, not a social welfare goal that reduces individual rights and autonomy to secondary concerns.

The Problem of Economic Calculation with Undefined Property Rights

We can extend the above line of reasoning using Ludwig von Mises's arguments on the impossibility of economic calculation under socialism.[25] As Mises put forth, measurements of economic costs and benefits only make sense within a system of defined property rights and market choice. Without property rights, no meaningful prices exist, and without prices, we have no reliable way to engage in economic calculation. This brings us to a point of contention with the efficiency norm. The economic theory of property rights wishes to define rights in a way that will maximize wealth,[26] but to Austrians there is a problem of infinite regress.[27] When property rights are not well defined, willingness-to-pay is indeterminate, and thus there is no unique assignment of property rights that maximizes wealth. As Gerald O'Driscoll writes, "Maximization makes sense if we know who has what rights, and what rules govern the choice process. The suggestion that the maximization principle be used to determine the rights distribution and the legal rules is almost incoherent."[28] Under such a system, judges would be in a position of central planners engaging in nonprice resource allocation.[29]

How can willingness-to-pay determine property rights when willingness-to-pay is determined by property rights? One of the fiercest defenders of the efficiency norm in law and economics, Richard Posner, puts his finger on the dilemma:

> A related problem is that where large allocative questions are involved, as in the initial assignment of rights, the very concept of wealth-maximization becomes problematic. Since the wealth of society is the output of all tangible and intangible commodities multiplied by their market values, it is difficult to compare the wealth of two states of society in which prices are different.[30]

Because willingness-to-pay is only meaningful within a system of clearly defined property rights, we have a circularity problem of using economics to render law. We would need to know who owns the property to solve these maximization problems. Unless we assume that all people are exactly the same and would spend their money exactly the same way, the assignment of property rights will be critical for evaluating economic outcomes.

As Rizzo and Tyler Cowen point out, the problem relates to the Scitovsky

Reversal Paradox, which shows the potential incommensurability of efficiency levels.[31] In certain cases, as Tibor Scitovsky wrote, "It is impossible to decide which of the two alternative situations is more efficient; and one may get the paradoxical result that each situation is more efficient than the other."[32] This is the case when the willingness-to-pay attached to one outcome exceeds another under the current assignment of property rights, but once property rights are rearranged, the ranking is the opposite. This problem can surface if preferences vary across individuals or over time. Because changes in property rights can alter the production possibilities frontier, even in a simple two person world we can have a situation where Andrew's preferred bundle is only attainable in state of the world *A*, and Barbara's preferred bundle is only attainable in state of the world *B*. Which state of the world is more socially efficient? The answer will depend on the distribution of property rights. When Andrew is assigned a large portion of the property rights, the net willingness to see *A* will be higher than to see *B*, but when Barbara is assigned a large portion of the property rights, the results will be the opposite.

Or consider Carl, who wishes to play basketball in the middle of the night much to the dismay of his neighbor Donna, who wishes to sleep in quiet.[33] If Donna is rich and Carl is poor, chances are that Donna is willing to pay a lot more for quiet than Carl is willing to pay to play basketball. In this case, quiet neighborhood is Kaldor-Hicks efficient. But if we reassign property rights so that Donna becomes poor and Carl becomes rich, as long as basketball and quiet sleep are normal goods to the respective parties, the willingness-to-pay associated with quiet will decrease and the willingness-to-pay associated with basketball will increase. Is the society with the late-night basketball richer than a society with halcyon nights? Because the different people have different preferences, the willingness-to-pay associated with the two outcomes will differ according to the assignment of property rights. As economists such as Harold Demsetz well recognize, we may not have the same outcome when wealth effects are significant.[34]

Not being able to determine the efficient outcome is an issue whenever property rights are up in the air. Consider someone who accidentally damages a statue outside the residence of a government official. Should the person who damages the statue be held liable for a tort?[35] Because Kaldor-Hicks does not evaluate the morality of the situation aside from the value of the consequences, the judge must examine willingness-to-pay and compare the cost of avoiding damaging the statue to the value of the statue. If the net willingness-to-pay attached to having the statue in place is positive, then damaging the statue is a social bad, and if the net willingness is negative (assuming the transaction costs of negotiating to remove the statue are prohibitive), then damaging the statue is actually socially beneficial. But the

judge's decision will clearly be contingent on the existing assignment of property rights. In societies where dictators own a large portion of resources, we see high prices associated with such statues (both the willingness-to-pay to purchase and remove the statues would be high), but the moment property rights are rearranged away from dictators, these statues become worthless, and, as we have seen historically, they are often intentionally destroyed. When the dictator owns most of the property, the state of the world with monuments is more efficient (the willingness-to-pay attached to that outcome is higher), but when individuals own most of property, the state of the world without monuments is more efficient. Is the society with numerous statues of government officials richer than a world without? Again, we cannot answer the question unless we know the distribution of property rights; as Rizzo writes, "There is no way, then, to stand outside the law and see how it measures up against an external standard."[36]

Finally, recognizing that the Coase theorem only holds when income effects are small[37] means the economic theory of property rights only can be applied to a limited realm.[38] Although it may be possible to analyze the efficiency of small, incremental changes in property rights, we may not be able to analyze the efficiency of existing property rights. But a complete economic theory of law would have to consider all possible states of the world to calculate the global optimum for wealth. Posner writes, "If transaction costs are positive, the wealth-maximization principle requires the initial vesting of rights in those who are likely to value them most."[39] But this brings us to the conundrum: We cannot determine how much people value anything if we have an indeterminate willingness-to-pay due to not knowing who owns what. Rizzo argues that, at most, the efficiency "norm is effective in prescribing small or marginal adjustments in the law," but that "it is impossible to assign basic rights in accordance with the efficiency norm."[40] This means that we need an exogenous justification of property rights and legal rules. If law and economics does not provide the basic fundamental rules, where do they come from? And how can we ever judge that those fundamental rules are efficient? Israel Kirzner argues that economic decisionmaking, and economic analysis itself, requires a system of preexisting property rights.[41] Law cannot be determined using economic costs and benefits because those economic costs and benefits can only be meaningfully determined under an existing system of law.

A Deontological Alternative to Wealth-Maximization

How else should judges decide cases? Despite the difficulty of implementing Kaldor-Hicks efficiency, one may believe judges might as well try, for lack of a better proposal. Even though judges have limitations, they could at least do their best to render wealth-maximizing decisions. But if Austrians economists are correct in their criticisms, the problem is more fundamental.[42] It is not a question of approximating efficient outcomes, because the maximum level of wealth, much less the policy to achieve it, is often ambiguous, especially in the "hard cases" that set legal precedents. This has led some, such as Paul Rubin, to criticize Austrians as being unable to judge the efficiency of policy evaluations.[43] But accepting the Austrian criticisms need not make one a nihilist about judging the world. Murray Rothbard writes, "I conclude that we cannot decide public policy, tort law, rights, or liabilities on the basis of efficiencies or minimizing of costs. But if not costs or efficiency, then what? The answer is that only *ethical principles* can serve as a criteria for our decisions."[44] We may not be able to judge law based on efficiency, but we are capable of judging it based on other standards.

Austrian economics is a positive endeavor that does not offer or recommend particular normative ends, but it can help identify the deficiencies in certain normative proposals. The neoclassical theory of law and economics depends on information that is impossible to obtain, and ultimately relies on its own conclusions, as seen in our discussion of the circularity problems with Kaldor-Hicks efficiency. In fact, utilitarian theories in general suffer from these calculation problems, but deontological theories, such as rights-based ethical systems, do not. In such theories, legal decisions would be made based on notions of justice rather than efficiency, and judges would not face the unenviable task of calculating the economic consequences, in all possible states of the world, of all their possible actions. As Posner describes this rival view, "We are then led, in the manner of [Robert] Nozick or [Richard] Epstein, to an ethical defense of market transactions that is unrelated to their effect in promoting efficiency."[45] Admittedly, when it comes to their normative views, not all Austrians embrace theories of rights, but a large number of them do.[46] These theorists are careful to note that their normative position does not stem from economics itself, but that normative positions on property rights provide a backdrop for their economic analysis: "The choice of a particular property rights structure is beyond the realm of economic science, and has no place in positive discussions of efficiency."[47]

We do not here attempt to argue the justice of any particular deontological theory or the general concept itself, but we do hold that rights theories offer a clear alternative to welfarism, especially if one agrees merely that judges are not well suited for determining efficiency. In what follows we provide a summary of the ethics of Immanuel Kant, who specified duties that moral agents must follow and can be translated into the language of rights. We choose Kant's moral system due to its essential and obvious contrasts with

many of the positions in the law and economics literature. This approach offers an alternative for those who reject the consequentialist ethics upon which neoclassical law and economics is based.

Kantian Ethics

Immanuel Kant is well known for his stand against consequentialist evaluation of moral decisions. To Kant the motivation of actions, not the consequences thereof, are of utmost importance in determining their moral status. As he wrote:

> An action done from duty has its moral worth, not in the purpose that is to be attained by it, but in the maxim according to which the action is determined. The moral worth depends, therefore, not on the realization of the object of the action, but merely on the principle of volition according to which, without any regard to any objects of the faculty of desire, the action has been done.[48]

In this sense, an attempted violation of rights would be considered just as wrong as an actual violation of rights, because the intention is the same even though the results differ. By the same token, a good act done for self-interested reasons would not be considered moral.

For an intended plan, or maxim, of action to be considered moral, it must meet two conditions: It must be based on duty, and it must also be performed out of that duty, not merely according to it. Duties are derived from the *categorical imperative*, Kant's formalization of "the moral law," which is an a priori deduction of one's reason. Kant wrote of three formulations of the categorical imperative, each emphasizing a different aspect of the moral law, but all three ideally equivalent. For our purposes, the second, the *Formula of Respect for the Dignity of Persons*, is the most useful: "Act in such a way that you treat humanity, whether in your own person or in the person of another, always at the same time as an end and never simply as a means."[49] To Kant, each rational agent has an intrinsic dignity stemming from her reason, and this dignity is not respected when anybody (including herself) uses a person simply as a means to an end. For instance, when Edith steals from Frank, she is using Frank as a means to obtaining the stolen goods for herself. If she were to treat Frank as an end and not just as a means, she would propose a transaction, and respect Frank's wishes no matter how Frank responded. This can also be interpreted as Edith's respecting Frank's right to his property, or more generally, his right not to be used merely as a means.[50]

This version of the categorical imperative directly rules out a number of

actions, perhaps most importantly (and controversially) the sacrifice of a few for the benefit of the many. This holds for acts most would consider clearly ignoble, such as eradicating one group of people simply because it would increase the happiness of others, but it would also hold for acts such as saving a life at the expense of harming an innocent bystander. It also applies to less dramatic circumstances, such as property and wealth transfers, which brings the categorical imperative into direct conflict with the neoclassical approach to tort law and Kaldor-Hicks efficiency, as we shall see.

Rights and Duties

From a Kantian perspective, we find many aspects of the treatment of tort law in normative law and economics objectionable.[51] One is the treatment of rights, including property rights as well as rights in one's person, as solely instrumental to achieving efficiency. Ronald Coase uses the example of a farmer's crops harmed by a rancher's cattle, and shows that the efficient solution is identical whether the rancher is liable for the damages or not. When transaction costs are low, and property rights are clearly vested in one party or the other, the farmer and the rancher will bargain, and the party valuing it the most will purchase or retain that right. Kantians would have no objection to this, as it represents a voluntary transaction, and the brilliance of Coase's analysis lies in the conclusion that the lowest-cost solution will be reached no matter who has the property right to begin with.

It is when transaction costs are high that Kantians would disagree with Coase. In such a case, under the wealth-maximization norm, the law should award the right to the party who *would have* purchased it in an ideal bargaining context. Coase writes:

> [T]he situation is quite different when market transactions are so costly as to make it difficult to change the arrangement of rights established by the law. In such cases, the courts directly influence economic activity. It would therefore seem desirable that the courts should understand the economic consequences of their decisions and should, insofar as this is possible without creating too much uncertainty about the legal position itself, take these consequences into account when making their decisions.[52]

According to this standard, the purpose of property rights is not to ensure justice but to maximize wealth, being assigned instrumentally to produce the lowest cost outcome.

On the other hand, Kantians view rights as stemming from duties, not from any cost-benefit calculation. Posner writes, "Another objection to using

[Kantian] autonomy directly as an ethical norm . . . is that it requires an arbitrary initial assignment of rights."[53] However, rights are *not* arbitrarily assigned in a Kantian system but, rather, outlined by duties; a duty not to lie implies a right not to be lied to, and a duty not to steal implies a right not to have your property stolen.[54] We can contrast this theory of rights with neoclassical law and economics in which "the institution of rights, and particular allocations of rights, are justified only insofar as they promote social wealth more effectively than other institutions or allocations."[55] As soon as rights fail to do this, they will be disregarded in the name of efficiency; indeed, as Posner writes, "When transaction costs are prohibitive, the recognition of absolute rights is inefficient."[56] Law and economics scholars take pride in the fact that many commonly accepted rights are validated by the efficiency criterion, such as "giving a worker the right to sell his labor and a woman the right to choose her sexual partners."[57] But as Ronald Dworkin points out, such analysis uses wealth-maximization to justify rights that wealth-maximization justifies, which reveals nothing about their independent moral worth.[58] Even when wealth maximization does happen to justify certain rights, that justification could disappear with the slightest change in relative costs and benefits. Kantians believe that rights, and the duties from which they derive, are absolute as determined by the moral law. They should never be determined or "allowed" by an efficiency-based calculation, augmenting the positive Austrian arguments cited earlier.

Hypothetical Compensation

As mentioned before, Kant's mandate never to treat individuals merely as ends prevents the implementation of Kaldor-Hicks efficiency. This is primarily due to the doctrine of *hypothetical compensation*: A decision is Kaldor-Hicks efficient if the winners gain enough to compensate the losers, although the compensation need not actually take place. As such, hypothetical compensation leaves us with merely a potential Pareto improvement, and even though it may benefit others, it comes at the expense of certain individuals. Even if government attempted to compensate the victims, as long as the losers do not consent, it would be objectionable, for no one has an obligation to undergo a specific sacrifice for the greater good.

If we do not rely on hypothetical compensation, how could policy evaluation proceed? The simple solution is to rely not on hypothetical but on actual consent.[59] With any market transaction based on mutual consent, we can assume that it is ex ante utility-enhancing to the parties involved. Disregarding any third party effects, Rothbard and Jeffrey Herbener consider this a version of the Pareto principle,[60] and Anthony Kronman states it in Kantian terms: "The Pareto principle represents a moral ideal based upon respect for the autonomy of individuals and acceptance of the idea that one should always treat others as ends in themselves and not merely as means."[61] We can contrast this with a situation where parties do not have to agree, and the state reorganizes property rights to increase total welfare. In the case of hypothetical compensation, "some committed to the Kantian idea of individual autonomy would rightly feel that his moral principle had been violated, and it would not make any difference, from his point of view, that compensation could potentially be made even though it was not. *For a Kantian, the Kaldor-Hicks test has no significance.*"[62] Stringham proposes that as long we can get individuals to privately agree to law ex ante, we can have a system based on consent, arguing that this can be done in a private system similar to arbitration agreements in business.[63]

Causation

Another aspect of the economic approach to tort law with which Kantians would disagree is *reciprocal causation*.[64] In standard applications of the Coase theorem, no blame or fault is assigned to either party in a conflict, and only the efficient solution is sought. In the words of Coase, "The question is commonly thought of as one in which *A* inflicts harm on *B*, and what has to be decided is, How should we restrain *A*? But this is wrong. We are dealing with a problem of a reciprocal nature. To avoid the harm to *B* would be to inflict harm on *A*."[65] According to the normative interpretation of the Coase theorem, society should be morally indifferent between instances of harm, leaving only the relative costs of each harm to determine the efficient solution. But to a Kantian the issue is of who harmed whom, or whose rights are violated by whom: "If a person's actions will affect the persons or property of others, those actions must conform to those others' rights—that is, they must be consistent in their external effects with the equal absolute moral worth of those others as free rational beings."[66]

Richard Epstein criticizes this aspect of Coase's thought, arguing that while Coase espouses a reciprocal view of causation, his examples are stated in terms of unidirectional harm: "Coase describes each situation by the use of sentences that differentiate between the role of the *subject* of each of these propositions and the role of the *object*."[67] The harm only becomes reciprocal, Epstein explains, when the harmed party seeks legal redress: "It would be a grave mistake to say that *before* the invocation of judicial remedies the grounds of dispute disclosed reciprocal harm. . . . The notion of causal reciprocity should not be confused with the notion of redress for harm caused."[68]

In Posner's reply to Epstein, he claims that "most torts arise out of a conflict between two morally innocent activities, such as railroad transportation and farming. What ethical principle compels society to put a crimp in the latter because of the proximity of the former?"[69] But Kantians have an answer to Posner's question: rights. A farmer may have the right not to have cattle travel on his property if he homesteaded the land first or purchased it from someone who had.[70] Or the rancher company may have the right to cross lands if it homesteaded the pastures first or purchased those rights from someone who had. A Kantian judge simply must determine who is the just owner of any given right. Suppose the farmer homesteaded his land first and only later did the ranchers come to the area. Before the rancher allows his cattle to stray on the farmer's property, he should ask the farmer's permission. In a Kantian interpretation, the rancher who fails to restrain his cattle from grazing on the farmer's land is violating his duty to respect the property of the farmer. The farmer is free to sell his right to the cattle-raiser, but that right is his to begin with, and should not be assigned to the cattle-raiser by a judge just because it is worth more to him. These actions are not "morally innocent" if someone's right is violated; once this is understood, "the structure and content of the modes of rectification for infringement [of rights] will be implicit in the rights themselves."[71]

Conclusion

Determining law using efficiency is questionable in a number of ways. From a positive Austrian perspective, we can question the meaningfulness of calculating costs and benefits when property rights are undetermined. In a world with an unclear or uncertain allocation of rights, it is impossible for judges to gauge the economic effects of their decisions. From a normative Kantian perspective, we can question whether individuals should be treated merely as ends in the pursuit of efficiency and social welfare. The notions of hypothetical compensation, reciprocal causation, and the instrumental nature of rights, all essential to the analysis of tort law in neoclassical law and economics, are all inconsistent with a Kantian respect for the dignity of persons. Austrians argue that economics cannot give us a complete theory of law, and Kantians argue it should not even if it could.

What remains to be done is to provide a constructive proposal for a better way to apply economic reasoning to the study and practice of tort law, making use of the Austrian and Kantian criticisms we have outlined. Such a program would emphasize the constraints placed on judges, both to acknowledge the informational difficulties of ambitious decisionmaking and to respect the rights of individuals, more than the ends the judges would attempt to achieve.

In fact, libertarian scholars (such as Robert Nozick and Murray Rothbard[72]) may have worked the most toward this end, as many of their ideas have significant overlap with Austrian economics and Kantian ethics. But to the extent that neoclassical law and economics continues to concentrate solely on wealth-maximization, social welfare, or efficiency in its approach to tort law, it will continue to overlook the insights provided by Austrian and Kantian thinkers.

Notes

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1. For instance, see Richard Posner, *The Economics of Justice*; David Friedman, *The Machinery of Freedom*; and Louis Kaplow and Steven Shavell, *Fairness Versus Welfare*. Kaplow and Shavell are probably the most extreme current proponents of this view, arguing that well-being should be the only criterion used in legal decisions, and any suggestion of sacrificing well-being in the interest of justice or rights to be "troubling" (8).
2. Mario Rizzo, "Law Amid Flux," 298.
3. Murray Rothbard, "Toward a Reconstruction of Utility and Welfare Economics," 236.
4. James Buchanan, *Cost and Choice*.
5. Mario Rizzo, "The Mirage of Efficiency," 641.
6. Ibid., 647.
7. Ibid., 643.
8. Edward Stringham, "Kaldor-Hicks Efficiency and the Problem of Central Planning."
9. Walter Block, "Coase and Demsetz on Property Rights," "Ethics, Efficiency, Coasian Property Rights and Psychic Income," and "Private-Property Rights, Erroneous Interpretations, Morality and Economics."
10. Block, "Ethics, Efficiency, Coasian Property Rights and Psychic Income," 87.
11. Block, "Coase and Demsetz on Private Property Rights," 114.
12. Block, "Private-Property Rights, Erroneous Interpretations, Morality, and Economics," 67, and Walter Block, "O.J.'s Defense: A *Reductio Ad Absurdum*."
13. See Steven Shavell, "Strict Liability Versus Negligence," for the orthodox treatment. For an approach to this problem based on Kantian social contract theory, see Gregory C. Keating, "A Social Contract Conception of the Tort Law of Accidents."
14. This is commonly known as the Hand Formula, first stated in Judge Learned Hand's decision in *United States v. Carroll Towing Co.*, 159 F.2d 169, 173 (2d Cir. 1947). See Richard Posner, *Economic Analysis of Law*, 179–83, for an excellent summary; and Richard Wright, "The Standards of Care in Negligence Law," for a critique (note that he mentions Hand's skepticism toward application of "his" formula, which sounds rather Austrian!).
15. Rizzo, "Law Amid Flux," 318.
16. Ibid., 307.
17. Ibid., 310.
18. Roy Cordato, *Welfare Economics and Externalities in an Open-Ended Universe*, 97.

19. Ibid., 109.
20. Ibid., 97.
21. An example would be a recording studio moving next to an airport, and then suing the airport to block its noise. See Donald A. Wittman, "First Come, First Served."
22. Cordato, *Welfare Economics and Externalities*, 100.
23. See the subsection "Hypothetical Compensation," below.
24. Mario Rizzo, "Rules Versus Cost-Benefit in the Common Law," 882.
25. Ludwig von Mises, *Economic Calculation in the Socialist Commonwealth.*
26. Richard Posner, "Utilitarianism, Economics, and Legal Theory," 109, 125–26.
27. Block, "Ethics, Efficiency, Coasian Property Rights and Psychic Income," 95.
28. Gerald O'Driscoll, "Justice, Efficiency, and the Economic Analysis of Law," 357.
29. Ibid., 359; Stringham, "Kaldor-Hicks Efficiency and the Problem of Central Planning."
30. Richard Posner, "The Ethical and Political Basis of the Efficiency Norm in Common Law Ajudication," 501.
31. Rizzo, "The Mirage of Efficiency," 650; Tyler Cowen, "The Scope and Limits of Preference Sovereignty," 254–58.
32. Tibor Scitovsky, "The State of Welfare Economics," 310.
33. Harold Demsetz ("Ethics and Efficiency in Property Rights Systems," 102) gives this example to illustrate the assignment of property rights matters when transaction costs are significant, and Block ("Ethics, Efficiency, Coasian Property Rights and Psychic Income," 86–89) discusses how we could decide who should have the rights to these activities.
34. Harold Demsetz, "Block's Erroneous Interpretations."
35. Depending on the legal system, this might be classified as a crime, but to even get to this point, we need to have a theory of crime versus torts. Murray Rothbard ("Law, Property Rights and Air Pollution," 102) argues the distinction between the two should not be made, and Bruce Benson's "Are Public Goods Really Common Pools?" shows historically that criminal law was an invention of government to generate more revenue than it could with the existing system of tort law.
36. Rizzo, "Mirage of Efficiency," 646. These issues are even more problematic when we are making income comparisons between different societies; see Amartya Sen, "Real National Income." We have to consider not just how one society would rank two social outcomes, but how two societies with different sets of preferences would compare outcomes. When price vectors, preferences, and population size in two societies differ, comparisons about which society is better off become even more awkward. As Rizzo writes in "The Mirage of Efficiency," 650: "If relative prices differ between the two societies, then the comparison of consumer surpluses is even more difficult." Cowen, in "The Scope and Limits of Preference Sovereignty," 258, adds: "Preference sovereignty can provide coherent rankings if and only if we can choose a baseline level of preferences (or wealth level) for comparing policies."
37. Demsetz, "Ethics and Efficiency in Property Rights Systems," 100.
38. Rizzo, "The Mirage of Efficiency," 651; Cowen, "The Scope and Limits of Preference Sovereignty," 267.
39. Posner, "Utilitarianism, Economics, and Legal Theory," 125.
40. Rizzo, "The Mirage of Efficiency," 651.
41. Israel Kirzner, *The Driving Force of the Market.*
42. Cowen, "The Scope and Limits of Preference Sovereignty"; Stringham, "Kaldor-Hicks Efficiency and the Problem of Central Planning."

43. Paul Rubin, "Predictability and the Economic Approach to Law," 320.
44. Rothbard, "The Myth of Efficiency," 95.
45. Posner, "The Ethical and Political Basis of the Efficiency Norm in CommonLaw Adjudication," 490.
46. For examples of those that do not embrace rights, see Henry Hazlitt, *The Foundations of Morality;* Ludwig von Mises, *Human Action;* and Leland Yeager, *Ethics as Social Science*. For those who do, see Kirzner, *The Driving Force of the Market*; Murray Rothbard, *For a New Liberty*; Hans-Hermann Hoppe, *The Economics and Ethics of Private Property*; Bryan Caplan, "The Austrian Search for Realistic Foundations," 834; Paul Cleveland, "The Failure of Utilitarian Ethics in Political Economy"; and Block, "Private-Property Rights, Erroneous Interpretations, Morality, and Economics."
47. Roy Cordato, "The Austrian Theory of Efficiency and the Role of Government," 402.
48. Immanuel Kant, *Grounding for the Metaphysics of Morals*, 399–400.
49. Ibid., 429.
50. This discussion of the categorical imperative is obviously incomplete. See Roger Sullivan, *An Introduction to Kant's Ethics*, for an overview; Roger Sullivan, *Immanuel Kant's Moral Theory*, for a detailed summary; and H.J. Paton, *The Categorical Imperative,* for an in-depth analysis.
51. Kant never discussed tort law outright; see Wright, "Rights, Justice, and Tort Law," 166.
52. Ronald Coase, "The Problem of Social Cost," 19.
53. Posner, *The Economics of Justice*, 98. For more on Kantian autonomy, see chapter 14 in this volume on a Kantian/social economics of crime.
54. The example of theft assumes the validity of property itself; we thank Margaret Oppenheimer for pointing this out. Immanuel Kant's thoughts on the institution of property can be found in *The Metaphysics of Morals*, pp. 260–70. See also Mary J. Gregor, *Laws of Freedom*, chap. 4; and Kenneth R. Westphal, "A Kantian Justification of Punishment."
55. Ronald Dworkin, "Is Wealth a Value?," 198.
56. Posner, *The Economics of Justice*, 70.
57. Ibid., 73.
58. Dworkin, "Is Wealth a Value?," 207.
59. For the consent to be just, it does require the existing set of property rights to be just to begin with.
60. Rothbard, "Toward a Reconstruction of Utility and Welfare Economics"; Jeffrey Herbener, "The Pareto Rule and Welfare Economics."
61. Anthony Kronman, "Wealth-Maximization as a Normative Principle," 235.
62. Ibid., 238 (italics added).
63. Edward Stringham, "Market Chosen Law."
64. For an Austrian statement, see Block, "Ethics, Efficiency, Coasian Property Rights and Psychic Income."
65. Coase, "The Problem of Social Cost," 96.
66. Wright, "Rights, Justice, and Tort Law," 165.
67. Richard Epstein, "A Theory of Strict Liability," 165.
68. Ibid., 165. Talcot Page makes the same point, that the notion of reciprocal harm confuses "a physical harm with the effects of a remedy" ("Responsibility, Liability, and Incentive Compatibility," 252). The concept of nonreciprocal harm may

ultimately have its roots in Aristotle's concept of "corrective justice"; see Aristotle, *Nicomachean Ethics*, section 5.5, for the original statement, and Wright, "Rights, Justice, and Tort Law," for the links between Aristotle's concepts of justice and Kant's later formulation.

69. Richard Posner, "Strict Liability," 216.
70. Rothbard, "Law, Property Rights, and Air Pollution."
71. Wright, "Rights, Justice, and Tort Law," 176.
72. Robert Nozick, *Anarchy, State, and Utopia*; Rothbard, *For a New Liberty*.

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